No. 13102

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JAMES M. McCLOSKEY, Trustee in Bankruptcy for Elliott Wholesale Grocery Company, a corporation,

Appellant,

v.

DIVISION OF LABOR LAW ENFORCEMENT, DEPARTMENT OF INDUSTRIAL RELATIONS, STATE OF CALIFORNIA,

Appellee.

APPELLEE'S BRIEF

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STATEMENT OF JURISDICTION

This appeal has been allowed by this court and is from an order of the United States District Court for the Southern District of California, Central Division, entered on July 25, 1951, which directs that appellee's claims for severance pay be allowed as claims entitled to priority under Section 64a (2) of the Bankruptcy Act, and that such claims also be allowed as statutory lien claims entitled to priority under Section 67b of the Bankruptcy Act. (Tr., p. 47.)

OPINION BELOW

The opinion of the district judge is found at pp. 40-45 of the Transcript of Record.

STATUTES INVOLVED

Bankruptcy Act, Section 64a (2): (U. S. Code, Title 11, Ch. 7, Sec. 104)

"a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * *."

Bankruptcy Act, Section 67b (U. S. Code, Title 11, Ch. 7, Sec. 107)

"The provisions of section 60 of this Act to the contrary nothwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII, or XIII of this Act, by or against him. * * *"

California Code of Civil Procedure, Section 1204

"When any assignment, whether voluntary or involuntary, and whether formal or informal, is made for the benefit of creditors of the assignor, or results from any proceeding in insolvency or receivership commenced against him, or when any property is turned over to the creditors of a person, firm, association or corporation, or to a receiver or trustee for the benefit of creditors, the wages and salaries of minors, mechanics, salesmen, servants, clerks, laborers, and other persons, for personal services rendered such assignor, person, firm, association or corporation, within 90 days prior to such assignment, or the taking over of such property, or to the commencement of the proceeding when a court action is involved, and not exceeding two hundred dollars ($200) each, constitute preferred claims and liens as between creditors of the debtor, and must be paid by the trustee, assignee or receiver before the claim of any other creditor of the assignor, insolvent, or debtor whose property is so turned over, and must be paid as soon as the money with which to pay same becomes available. * * *"

QUESTIONS PRESENTED

1. Is severance or dismissal pay, in lieu of notice, wages entitled to priority under Section 64a (2) of the Bankruptcy Act?

2. Is severance or dismissal pay, in lieu of notice, wages entitled to lien status under Section 1204 of the California Code of Civil Procedure and thus entitled to priority under Section 67b of the Bankruptcy Act?

SUMMARY OF ARGUMENT

Severance or dismissal pay becoming due under a collective bargaining contract upon failure of an employer to give notice of discharge is wages within the meaning of Section 64a (2) of the Bankruptcy Act and Section 1204 of the California Code of Civil Procedure. Like vacation pay, holiday pay and other forms of additional remuneration, it is part of the wage compensation agreed upon.

Severance pay may be of two types: (1) that which accrues over a specified period of time in similar fashion to most vacation pay provisions and (2) severance pay in lieu of notice which is earned and accrues at the moment of discharge without reference to prior service, and is for the week for which the notice was not given. A provision for severance pay is not an agreement to pay liquidated damages. The right to it is wages within the terms of the hiring and not damages for breach of contract.

ARGUMENT

I. "Severance" or "Dismissal" Pay, Given in Lieu of Notice, Is Wages Under Section 64a (2) of the Bankruptcy Act and Wages for Personal Services Under Section 1204 of the California Code of Civil Procedure

It is now well settled that "severance" or "dismissal" pay constitutes wages within the meaning of the Bankruptcy Act.

In re Public Ledger, 161 F. (2d) 762;
In re Men's Clothing Authority, 71 F. Supp. 469.

The *Public Ledger* case, supra, is widely recognized as the leading authority upon the subject of severance pay and its reasoning is properly determinative of this case. In the *Public Ledger* case Judge Albert Lee Stephens considered the legal effect of two collective bargaining contracts, each of which contained provisions for severance pay. The Typographical Union contract provided for a two-day notice prior to layoff. The court stated, with respect to the contract provisions regarding severance pay (page 770):

> "They are a part of the wage compensation agreed upon and are entirely reasonable as protection to the workman against having his needed income stop without even a day to meet emergencies.
> * * *
>
> "The claims under the layoff provision of the contract are for wages. The provision protects against a sudden, unexpected and unprepared for stoppage of wages. It provides that knowledge of a break in the continuity of work and the consequent lack of pay shall be given the employee and it is the employer's duty to give it. If he does not give it, the wage continues unaffected for the term of the required notice. Whether the layoff occurs through bankruptcy or any other cause does not affect the validity of this wage requirement. For the lack of a better term, we call this contractual arrangement one for severance pay."

Severance pay has also been held to constitute wages in state liquidation and dissolution proceedings.

In re Brooklyn Citizen, 90 N. Y. S. (2d) 99;
Montefalcone v. *Banco Di Napoli,* 268 App. Div. 636; 52 N. Y. S. (2d) 655;

In accordance with the general rule, severance pay has likewise been held to be "wages" under maritime law entitling seamen to a lien for wages earned.

Gayner v. *The New Orleans,* 54 F. Supp. 25.

For purpose of federal tax laws, severance payments made to employees are generally regarded as wages.

Poorman v. *Commissioner,* 131 Fed. (2d) 946.

See also:

1 Mertens, *Law of Federal Income Taxation,* 1942, Section 8.08.

The classification of severance pay as wages is in accord with the general rule that other supplemental or additional compensation constitutes wages. This has long been the rule in the federal courts with respect to vacation pay. Thus, *In re Wil-low Cafeterias, Inc.,* 111 F. (2d) 429, 432, states:

> "A vacation with pay is in effect additional wages. * * *"

This is the rule regarding vacation pay that has been adopted by this court.

Division of Labor Law Enforcement v. *Sampsell,* 172 F. (2d) 400.

As stated by the district judge in his opinion in the case at bar (Tr., p. 42):

> "Provisions of this character, whether they call for wages on discharge without notice, or for payment for earned vacation periods, are generally

considered wages—that is, compensation for services rendered, which, through no fault of the employee, he was not permitted to render. * * *"

II. The Severance Pay in the Case at Bar Was Earned at the Time of Discharge

Severance pay may be defined as the payment of a specific sum, in addition to any back wages or salary, made by an employer to an employee for permanently terminating the employment relationship primarily for reasons beyond the control of the employee.

Gayner v. *The New Orleans,* supra;
Hawkins, *Dismissal Compensation,* pp. 5-6, Princeton University Press, 1940;
U. S. Dept. of Labor, *Monthly Labor Review,* Vol. 70, No. 4, April, 1950, p. 384.

Severance or dismissal pay was a novelty, if not completely unknown, in the early days of commerce and industry in this country. It is thus not to be found referred to in early definitions of the term "wages" or in the early case law. Today, however, it is frequently contained in collective bargaining agreements as part of the compensation provided for by such contract.

Hawkins, *Dismissal Compensation,* supra, pp. 19, 29-33.

Severance pay, like vacation pay, premium pay, and other elements of a worker's earnings, is wages under the contract of hire; it is earned and becomes payable under whatever conditions are specified by the employer in his promise.

Such dismissal or severance wages can be said to fall into two broad categories: On the one hand, are those types that accrue day by day or month by month, as the employee's length of service increases, and to which he becomes entitled upon termination or dismissal, either on a pro rata basis or after the completion of a specified period of employment.

On the other hand, severance pay may fall into a *second* and *different* category, and this is *severance pay in lieu of notice.* Such is the severance pay in the case at bar.

In the first class of severance pay mentioned above, eligibility for payment relates to employment for a given period. This severance pay can be likened to most vacation pay agreements, which likewise almost uniformly are based upon length of service.

Division of Labor Law Enforcement v. *Sampsell,* 172 F. (2d) 400;
In re Wil-low Cafeterias, Inc. (supra).

Such severance pay has been described as "an equity which the individual employee builds up in his job and for which he should be compensated when discharged for cause or economic reasons, or when he resigns, retires or dies. The longer an employee works for one employer, the greater his equity in the job."

U. S. Dept. of Labor, Bureau of Labor Statistics, Bulletin No. 908-5, p. 35 (1948), *Collective Bargaining Provisions and Dismissal Pay Provisions.*

In *Division of Labor Law Enforcement* v. *Sampsell,* supra, this court held that where vacation pay was conditioned upon prior employment for a year, such vacation earnings would be deemed spread over the entire period; that although it became due during the priority period, since the contract provided a *further* condition of prior employment, such previous service must necessarily also be considered as the earning period, and such employee earned his vacation day by day during the year, in accordance with the condition of the promise. The court thereupon concluded that only one-quarter of the vacation was earned in the three months prior to completing the year of service. Like the vacation pay in the *Sampsell* case, severance or dismissal pay *conditioned on prior employment* would be held to be earned and accrued as the employment progressed. Thus, applying the rule of the *Sampsell* case, only the portion of severance pay accruing during the three months immediately prior to assignment or bankruptcy would be entitled to lien status or priority as wages under Section 64a (2) of the Bankruptcy Act.

Appellant's dissatisfaction with the decision of the district judge in the case at bar appears based upon the misconception that severance pay can only be earned gradually as work progresses. But the severance pay here is of the *second* type mentioned above.

Such severance or dismissal pay in lieu of notice could be equally described as "notice pay." However

designated, it is unrelated to any period of prior service or length of service. It is wholly related to the lack of notice. It is for this reason, as the district judge made clear, that the pay is *wages for the period of the prescribed notice which was not given;* thus, *no specific period of service* is required. Hence, the week's wages are not allocable to a year or six months or three months of employment. They are instead allocable only to the week in which they were earned and in which they accrued, which is the week for which the notice was not given.

The same situation was present in the *Public Ledger* case. There the Typographical Union contract provided for severance pay in the absence of the required notice, regardless of the length of service by the employee. The statement at page 771 of the court's opinion delineates the law with respect to the specific problem found in the case at bar:

> "The severance pay, in that it moves to all employees, *regardless of length of service,* is held to be wages wholly earned and accrued under the trustee's management and, therefore, is entitled to priority as such." (Emphasis added.)

In the case at bar, the severance pay likewise does not depend upon the length of service, and likewise is payable only if the required notice is not given.

The contract provides, in Article 3, Section 5 (Tr. p. 27):

> "Except for dishonesty, drinking on the job, or gross insubordination, the employer shall give one week's notice or *one week's pay in lieu thereof*

when discharging or laying off an employee. Employees desiring to quit their job shall give the employer one week's notice." (Emphasis added.)

By the very terms of the contract, the payment to be given in lieu of the notice is one week's pay. This week's pay becomes earned upon the failure of the employer to give the week's notice.

As stated by the district court (Tr., p. 44):

"* * * When the employer does not give the notice, either through voluntary choice or by force of circumstances, he is required to pay a week's wages. The wages are compensation for the week. * * *"

Whether this week be deemed the week immediately prior to or immediately after the discharge, the wages are earned within the priority period and relate directly to the services of the employee under the terms of his employment contract.

Appellant argues that no wages could be "earned" unless earned for specific work, and that no "work" was performed for the severance pay. (Appellant's Brief, p. 15). Appellant appears to claim that in order to *earn* wages the employee must be performing services every minute, hour or day. Such a view is not in accordance with accepted present-day concepts of the nature of earnings from employment. A person may earn wages equally when he is performing no services for his employer as when he is working at the machine or the desk. He may earn wages although the employer provides no work for him to do. Also, he may

be earning wages even though at the same time he is engaged on other business personal to himself. The true test is whether or not the sum to be paid is related to and is a part of the agreed remuneration to which he is entitled under the terms of the employment contract.

Nierotko v. *Social Security Board,* 149 F. (2d) 273, 275; affirmed, 327 U. S. 358; 66 S. Ct. 637; 162 A. L. R. 1445;

Day-Brite Lighting v. *Missouri,* 96 L. Ed. (Adv. Ops.), 343, 345. (U. S. Sup. Ct., Mar. 3, 1952);

In re B. H. Gladding Co., 120 F. 709, 711.

Modern conditions of employment under collective bargaining contracts provide for the earning of wages calculated upon a variety of bases, in addition to regular pay for services rendered. Some of these are directly related to the actual rendition of particular services, such as overtime pay and premium pay; others relate to past services, such as when vacation pay and severance pay are based upon length of services; and still others relate to time to be paid for, though not worked, such as holiday pay or services that would have been performed if the employer had maintained the employment relationship in a particular manner, such as minimum wages, stand-by time, reporting time, and severance pay in lieu of notice. In each of these cases wages are earned, though no specific services are performed for such wages. Thus, severance pay in lieu of notice is the wages earned for the period the worker would have worked if the

prescribed notice had been given—*it is wages for the period of the notice.*

Cliffords Olympia Co. v. *Waters,* 84 Ill. App. 664;
National Overall Dry Cleaning Co. v. *Yauner,* 321 Mass. 434, 73 NE. (2d) 744.

In the *Yauner* case the court states (p. 439):

> "The lack of a formal notice in and of itself would not be of controlling significance, because the discharge on September 3, 1946, was the equivalent of such a notice and the absence of such notice would not deprive the defendant of his wages for the subsequent week and, if not paid when due, he could recover those wages in an action at law, but that would be the full measure of recovery."

The error of considering severance pay as constituting a claim for liquidated damages, as was done by the referee in the case at bar (Tr. p. 28), is also disposed of in the *Public Ledger* case. There the contention was made that a provision for severance pay upon dismissal was in effect a provision for damages for breach. After citing *Gaspar* v. *United Milk Producers of California,* 62 Cal. App. (2d) 546, which held that a cessation of employment by reason of the sale of the business constituted a discharge, the court distinguished various New York cases and declared (pp. 772-3):

> "They do not involve severance pay contractual provisions but rather damages for alleged breaches of contracts of employment. The claims in those cases were based on the theory that a collective

bargaining agreement amounted to a promise by the employer to furnish each member of the contracting union employment for the term of the contract. The cases hold that such a theory is incorrect. In the instant case the claims are not for damages for breaching the contract to keep the Guild members employed for the contractual period beyond January 5, 1942, but rather for severance pay, which accrued under the contract when they lost their jobs through the business management's act of shutting the business down."

This court has declared in *Blessing* v. *Blanchard,* 223 F. 35, 37, that priority of payment of wages provided for under the Bankruptcy Act is intended for the benefit of "those who are dependent upon their wages, and who, having lost their employment by the bankruptcy, would be in need of such protection."

It is appellee's position that the provision for dismissal or severance pay, agreed to be given in lieu of notice, is to accomplish and implement the very objective of the priority provisions of the Bankruptcy Act which insure preference for the final earnings of employees who help create the assets of the bankrupt, but are not apt to be aware of impending insolvency, bankruptcy or assignment. Appellee submits that where an employer has sought to insure to his employees a week's wages after the worker learns he is to lose his job, this court should not declare that such purpose is to be frustrated; an employer's insolvency or bankruptcy should not cause the worker's protection against sudden discharge to be relegated to the

status of a commercial creditor. Appellee further submits that this court should give effect to the specific purpose of severance pay in lieu of notice: that it be held earned at the time of discharge for the week of the notice, and therefore entitled to preferred status under Sections 64a (2) and 67b of the Bankruptcy Act.

CONCLUSION

The order and judgment of the district court should be affirmed.

Respectfully submitted,

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